

## Message Text

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PASS: CEA (CHAIRMAN SCHULTZE), TREAS (WIDMAN), FRB  
(PARTEE)

E.O. 11652: GDS  
TAGS: OECD, ECON  
SUBJECT: MARCH 1-2 MEETING OF THE ECONOMIC POLICY  
COMMITTEE (EPC): COMMUNALITY OF CONCERN, BUT SOME  
CONTRASTS IN JUDGMENTS ON SITUATION, OUTLOOK AND POLICY  
REQUIREMENTS OF OECD COUNTRIES ECONOMIC STRATEGY AND  
ADJUSTMENT PROCESS

REF: (A) CPE(77)1; (B) CPE/WP3(77)2; (C) CPE/WP2(76)8;  
(D) OECD PARIS 6420; (E) OECD PARIS 5945

1. SUMMARY AND OVERVIEW: AT ITS MARCH 1-2 MEETING, THE  
EPC TOOK STOCK OF RECENT AND EXPECTED PROGRESS UNDER  
OECD'S STRATEGY FOR NON-INFLATIONARY GROWTH (APPROVED  
AT 1976 MINISTERIAL MEETING) AND FOCUSED ON QUESTION OF  
POLICIES WHICH WOULD BE APPROPRIATE TO INSURE THAT PRO-  
GRESS OF CURRENT ACCOUNT ADJUSTMENT WOULD BE CONSISTENT  
WITH ACHIEVEMENT OF THE OVERALL GOALS OF THAT STRATEGY.  
THERE WAS COINCIDENCE OF VIEWS ON MANY ASPECTS, BUT ALSO  
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VARYING OPINIONS PARTICULARLY BETWEEN SOME OF THE  
STRONG AND WEAK COUNTRIES AND AMONG WHAT WAS CHARACTER-  
IZED AS "NAIVE" AND "WARY" KEYNESIAN OUTLOOKS ON ECONO-  
MIC POLICY. GERMANS CAME EXPECTING TO BE AT CENTER OF  
CRITICAL ATTENTION AND WERE. QUESTIONING OF GERMAN  
POLICY MET SKILLFUL DEFENSE. JAPAN'S DETERMINATION TO  
MEET GROWTH TARGETS ALSO QUESTIONED.

2. MAIN CONCLUSIONS OF MEETING WERE: (A) EPC GENERALLY CONFIRMED MERITS OF THE APPROACH OF THE MEDIUM-TERM STRATEGY AND URGED CONTINUED APPLICATION OF ITS PRINCIPLES; INFLATION STILL CONSIDERED A CLEAR AND PRESENT DANGER; (B) COUNTRIES ALSO SUPPORTED STRATEGY IN CONTEXT OF THE POLICY REQUIREMENTS OF CURRENT ACCOUNT ADJUSTMENT PROCESS (DRAWING ON WP3 DISCUSSION REPORTED REFTEL D). FRG, WHOSE EXPANSION IS EXPECTED TO MAKE A SIGNIFICANT CONTRIBUTION TO OECD AREA RECOVERY, BUT WHOSE ACTUAL PERFORMANCE IS IN QUESTION, GAVE ASSURANCE THAT ADDITIONAL STIMULATORY MEASURES WOULD BE TAKEN IF REAL GROWTH WERE TO FALL SHORT OF OFFICIAL FORECASTS. (FRG INDICATED CRUCIAL ROLE REDUCTION OF UNEMPLOYMENT PLAYS IN ITS OWN DOMESTIC PRIORITIES.) DEFICIT COUNTRIES GENERALLY ACCEPTED THE NEED FOR CONTINUED RESTRAINT ON DOMESTIC DEMAND, WHILE STRESSING THAT THERE WERE LIMITS TO THE AMOUNT OF COMPRESSION THEY COULD TOLERATE. THEY DID NOT URGE SURPLUS COUNTRIES TO REFLATE BEYOND THRESHOLD OF INFLATIONARY TOLERANCE, BUT FELT THAT WHERE BALANCE OF RISK BETWEEN SHORTFALL IN GROWTH AND HIGHER INFLATION WAS UNCERTAIN, STRONG COUNTRIES SHOULD OPT FOR MORE EXPANSION; (C) MEDIUM-TERM STRATEGY SHOULD NOT BE VIEWED AS A STATISTICAL EXERCISE CONTAINING A TARGETED GROWTH PATH OF 5 PERCENT (#) FOR OECD AREA TO 1980, BUT AS A SET OF POLICY GUIDELINES SUPPLEMENTED BY A ROUGH ILLUSTRATIVE QUANTIFICATION OF GROWTH RATE WHICH WOULD BE CONSISTENT WITH REDUCTION OF INFLATION AND GRADUAL RETURN TO FULL EMPLOYMENT.

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3. IN GENERAL, DEFICIT COUNTRIES PREDICTABLY FAVORED MORE RAPID EXPANSION IN SURPLUS COUNTRIES. HOWEVER, EPC DID NOT DIVIDE NEATLY INTO TWO MONOLITHIC CAMPS IN THIS RESPECT. SOME DEFICIT COUNTRIES (UK) FELT THAT BURDEN OF RESPONSIBILITY FOR BALANCE OF PAYMENT ADJUSTMENT SHOULD REST WITH SURPLUS COUNTRIES. SECRETARIAT (MARRIS) JOINED IN THIS VIEW. OTHERS CALLED FOR SPECIFIC LINKAGE BETWEEN DEMAND MANAGEMENT POLICY COMMITMENTS AND TRADE PLEDGE (NEW ZEALAND, TURKEY). AUSTRALIA, HOWEVER, URGED MODERATION IN SURPLUS COUNTRIES AND DISCIPLINE IN THE WEAK SISTERS. ON OTHER HAND, U.S. (CEA CHAIRMAN SCHULTZE) SUPPORTED VIEW OF MODERATE DEFICIT COUNTRIES BY IMPLYING THAT FRG COULD AFFORD TO TAKE SOME UPSIDE EXPANSIONARY RISK. HE DID NOT, HOWEVER, EXPLICITLY

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ADDRESS GERMAN CASE AT EPC MEETING. (NOTE: IN BRIEF  
ENCOUNTER WITH PRESS, SCHULTZE SAID ESSENTIALLY: (A) NO  
CONFRONTATION BETWEEN U.S. AND FRG HAD TAKEN PLACE IN  
EPC; (B) GERMAN QUESTION HAD TWO ASPECTS -- THAT OF FORE-  
CASTED RATE OF GROWTH IN 1977, AND THAT OF HOW THE BAL-  
ANCE OF RISKS SHOULD INFLUENCE THE STANCE OF POLICIES;  
(C) HE HAD NOT ADDRESSED THE FIRST ASPECT IN EPC, WHILE  
ON THE SECOND HAD SENT A "SIGNAL" THAT FRG COULD AFFORD  
TO TAKE SOME UPSIDE RISK.

4. EPC BUREAU MET MARCH 1 AND AGREED TO MEET AGAIN IN  
WASHINGTON PROBABLY APRIL 28 (DURING APRIL 27-28 IMF  
INTERIM COMMITTEE MEETING). MAIN PURPOSE WILL BE INFORMAL  
CONSIDERATION OF A SECRETARIAT ASSESSMENT OF ECONOMIC  
OUTLOOK WHICH WILL BE PREPARED FOR THE OCCASION. BUREAU  
ALSO AGREED ON LINE TO BE TAKEN BY EPC CHAIRMAN ALLEN AT  
MARCH 2 PRESS CONFERENCE, AND HAD BRIEF, INCONCLUSIVE  
DISCUSSION OF CONCEPT OF AN INTEGRATED POLICY COORDINA-  
TION STRATEGY (SEE PARA 22-24).

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5. EPC ADOPTED RECOMMENDATION TO OECD COUNCIL THAT

LATTER APPROVE PUBLICATION OF WP2 REPORT ON PUBLIC EXPENDITURE ON HEALTH (REF C).

6. NEXT EPC PLENARY TENTATIVELY SET FOR JUNE 14-15.  
END SUMMARY

7. THE ADJUSTMENT PROCESS; THE MAGNITUDE OF THE PROBLEM: REPORTS BY WP3 CHAIRMAN EMMINGER AND TWP CHAIRMAN VAN YPERSELE TO EPC ON CONCLUSIONS OF RECENT MEETINGS OF THEIR COMMITTEES (SEE REFTELS D FOR WP3 AND E FOR TWP) SET BACKGROUND FOR DISCUSSION OF POLICIES REQUIRED TO INSURE THAT PROGRESS IN CURRENT ACCOUNT ADJUSTMENT WOULD BE CONDUCIVE TO ACHIEVEMENT OF GOALS OF MEDIUM-TERM STRATEGY FOR SUSTAINABLE GROWTH. REFERRING TO ISSUE (RAISED PARA 15(B), REF A) OF WHETHER SLOW PROCESS IN CURRENT ACCOUNT ADJUSTMENT REPRESENTED OBSTACLE TO ACHIEVEMENT OF STRATEGY'S OVERALL GOALS, EMMINGER NOTED WP3 CONSENSUS THAT CURRENT ACCOUNT SURPLUS OF STRONG COUNTRIES EXPECTED TO FALL FROM \$11 BILLION IN 1976 TO \$3-1/2 BILLION IN 1977, WHILE DEFICIT OF MAJOR WEAK COUNTRIES PROJECTED TO DECLINE FROM \$11 BILLION IN 1976 TO \$4 BILLION THIS YEAR. EMMINGER (WHOSE REPORT WAS A MIXTURE OF WP3 CONCLUSIONS AND FRG POSITIONS) CONCLUDED FROM ABOVE FIGURES THAT ADJUSTMENT PROCESS WAS PROCEEDING AS RAPIDLY AS COULD BE EXPECTED AND COULD NOT BE ACCELERATED. HE ADDED THAT BURDEN OF ADJUSTMENT SHOULD REST WITH DEFICIT COUNTRIES, ALTHOUGH STRONG COUNTRIES SHOULD ACCOMMODATE IT. FINALLY, HE EMPHASIZED THAT MEDIUM-TERM CURRENT ACCOUNT "REFERENCE CASE" FIGURES PRESENTED BY SECRETARIAT TO WP3 (SEE REF B) SHOULD BE CONSIDERED HIGHLY PROVISIONAL SINCE MANY COUNTRIES QUESTIONED UNDERLYING ASSUMPTIONS AT THE EXERCISE AND SINCE, IN ANY CASE, THESE FIGURES WERE ILLUSTRATIVE PROJECTIONS, NOT FORECASTS.

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8. VAN YPERSELE INDICATED THAT DEFICIT OF SMALLER OECD COUNTRIES SHOULD DECLINE BETWEEN 1976 AND 1977 AND THAT WITH EXCEPTION OF PORTUGAL, TURKEY AND POSSIBLY SPAIN, SMALL COUNTRIES DID NOT EXPECT EXTERNAL FINANCING PROBLEMS IN SHORT RUN. (SINCE VAN YPERSELE'S REPORT TO EPC WAS VIRTUALLY SAME AS HIS STATEMENT AT WP3, SEE REFTEL E FOR DETAILS.)

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9. ACCELERATING THE ADJUSTMENT PROCESS: ROLE OF DEMAND MANAGEMENT POLICIES: EPC AGREED THAT THE MALDISTRIBUTION OF THE CURRENT ACCOUNT DEFICIT WITHIN THE OECD AREA CONSTITUTED A SERIOUS OBSTACLE TO THE ACHIEVEMENT OF THE GOALS OF THE MEDIUM-TERM STRATEGY. FURTHERMORE, MOST COUNTRIES FELT THAT INSUFFICIENT DIFFERENTIATION BETWEEN THE DEMAND MANAGEMENT POLICIES OF THE STRONG AND WEAK COUNTRIES WAS THE MAJOR FACTOR EXPLAINING THE SLOW PROGRESS TO DATE IN PRODUCING A SUSTAINABLE PAYMENTS PATTERN. WEAKER COUNTRIES AND SECRETARIAT POINTED TO U.S. AS AN EXAMPLE OF STRONG COUNTRY WHICH HAD ACTED IN MANNER ENTIRELY CONSISTENT WITH NEEDS OF ADJUSTMENT PROCESS AND WITH AIMS OF MEDIUM-TERM STRATEGY. SECRETARIAT SOLICITED U.S. VIEWS ON NEW ADMINISTRATION'S STIMULATORY PACKAGE.

10. CEA CHAIRMAN SCHULTZE EXPLAINED THAT NEW STIMULATORY PROGRAM WAS FORMULATED ACCORDING TO FOLLOWING CRITERIA: (A) STIMULUS SHOULD TAKE EFFECT QUICKLY;  
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(B) PROGRAM SHOULD BE OF SUFFICIENTLY LONG DURATION TO CREATE EXPECTATION OF SUSTAINED EXPANSION; (C) STIMULUS SHOULD BE LARGE ENOUGH TO RAISE LEVEL OF CAPACITY

UTILIZATION (AND HENCE BRING FORTH INCREASED INVESTMENT), BUT NOT SO LARGE AS TO EXCITE INFLATIONARY EXPECTATIONS AND (D) GIVEN ADMINISTRATION'S DESIRE TO EFFECT STRUCTURAL REFORMS LATER ON, SHORT-RUN STIMULUS SHOULD NOT GENERATE PERMANENT INCREASE IN SPENDING, OR REDUCTION IN REVENUE. MEASURES SHOULD THUS BE TEMPORARY AND REVERSABLE. WITH NEW PROGRAM, U.S. ESTIMATED THAT U.S' GNP WOULD RISE BY 5.75 - 6 PERCENT BETWEEN FOURTH QUARTER OF 1976 AND FOURTH QUARTER OF 1977. HOWEVER, CONFLUENCE OF (A) SMALL ACCELERATION OF INFLATION, DUE TO EFFECTS BAD WEATHER ON FOOD PRODUCTION, (B) A PROBABLE SPURT IN FIGURES FOR GROWTH IN THE SECOND QUARTER FOLLOWING A LOSS OF OUTPUT IN THE FIRST QUARTER, AND (C) INITIATION OF NEW STIMULUS CARRIED DANGER OF AWAKENING INFLATIONARY EXPECTATIONS EVEN IN ABSENCE OF ANY CHANGE IN UNDERLYING RATE OF INFLATION. (SECRETARIAT WAS COMFORTED BY IMPLICATION OF U.S. STATEMENT THAT ACCELERATION OF INFLATION DUE TO ADVERSE WEATHER WOULD NOT IN ITSELF CONSTITUTE REASON FOR OFFSETTING POLICY REACTION.) FURTHERMORE, U.S. EMPHASIZED THAT ADMINISTRATION'S PROGRAM WAS ALSO DESIGNED TO REDUCE INVESTMENT-IMPEDING RISK PREMIA BY UNDERTAKING REVIEW OF BUSINESS TAXATION AND BY CLARIFYING (AND MAKING MORE PREDICTABLE) VARIOUS REGULATIONS (I.E., CONCERNING ENVIRONMENT) WHICH AFFECT INVESTMENT DECISIONS. U.S. THUS VIEWED PROGRAM AS ESTABLISHING THE NECESSARY (REDUCTION OF EXCESS CAPACITY) AND SUFFICIENT (MORE PERMANENT STRUCTURAL REFORMS) CONDITIONS FOR GENERATING INCREASED INVESTMENT. FINALLY, U.S' (PARTEE) NOTED THAT TARGETS SET FOR GROWTH OF MONETARY AGGREGATES IN 1977 SHOULD BE ADEQUATE (ALBEIT WITH A FAIRLY TIGHT FIT) FOR EXPECTED GROWTH OF NOMINAL GNP. HE CITED DANGER, HOWEVER, THAT

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TEMPORARY ACCELERATION IN GROWTH OF AGGEGATES IN PERI IMMEDIATELY FOLLOWING THE TAX REBATE COULD, WITH TEMPORARY FACTORS CITED BY SCHULTZE, AFFECT INFLATION;RY EXPECTATIONS. FOR IN COMMENT TE IN FIRST DAY, TIMED TO CATCH CHAIRMAN SCHULTZE BEFORE HIS DEPARTURE, SECRCTARIAT (MARRIS) STRESSED THAT LARGE MEMBER COUNTRIES COULD RENDER A SERVICE TO THEMLVES AND OTHERS BY REDUCING THEIR DEPENDENCE ON IMPORTED OIL.

11. IF U.S. WAS THE "WHITE HAT" ON THE SURPLUS COUNTRY SIDE, FRG WAS NOT. FRG (TIETMEYER) EVIDENTLY EXPECTING TO BE AT CENTER OF CRITICAL ATTENTION AT THE EPC, CAME FULLY PREPARED AND LAUNCHED IMPRESSIVE DEFENSE OF FRG'S CAUTIOUS DEMAND MANAGEMENT POLICY STANCE. TIETMEYER STRESSED THAT (A) EC AND IMF (IN RECENT

"WORLD OUTLOOK") CONCURRED IN GERMAN AUTHORITIES' FORECAST OF 5 PERCENT GROWTH FOR 1977 (COMPARED WITH 3.5 PERCENT FORECAST OF OECD SECRETARIAT); (B) MEDIUM-TERM STRATEGY ADVANCES IDEA THAT FLUCTUATIONS AROUND INTENDED GROWTH PATH WITHIN "POLICY CORRIDOR" SHOULD NOT TRIGGER POLICY ACTION. FRG GROWTH RATE IS INSIDE CORRIDOR; (C) "NAIVE KEYNESIANISM", WHICH HOLDS THAT SHORT-TERM STIMULUS CAN IMPROVE GROWTH, DIED WITH THE PASSING OF "MONEY ILLUSION". STIMULATORY ACTION QUICKLY AWAKENS INFLATIONARY EXPECTATIONS AND IS THUS COUNTER-PRODUCTIVE; (D) FRG'S LIBERAL IMPORT POLICY DEMONSTRATED BY OVER PROPORTIONATE GROWTH OF IMPORT VOLUMES RELATIVE TO GROWTH OF GNP IN 1976 AND

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HAS PROVIDED STRONG ASSIST TO DEFICIT COUNTRIES. (FRG CONTRASTED THIS WITH VEILED CRITICISM OF FRANCE'S "BUY FRENCH" PLAN AND WITH FACT THAT RISE IN U.S. DEFICIT LARGELY OIL-RELATED AND THUS OF LITTLE HELP TO OTHER OECD COUNTRIES); (E) BUDGET DEFICIT ALREADY TOO HIGH. TIETMEYER CONCLUDED THAT 5 PERCENT WAS MAXIMUM SAFE GROWTH RATE AND THAT FURTHER DIFFERENTIATION IN OECD MEMBER COUNTRIES' POLICIES WOULD HAVE TO RESULT FROM MORE RESTRAINT ON PART OF DEFICIT COUNTRIES. NONETHELESS, FRG EMPHASIZED THAT IF GROWTH RATE

WERE TO FALL SHORT OF OFFICIAL EXPECTATIONS, CORRECTIVE MEASURES WOULD BE TAKEN, BUT IN CONTEXT OF MEDIUM-TERM INVESTMENT PROGRAM AND NOT AS A SHORT-TERM PALLIATIVE (ALTHOUGH GERMANS LATER MENTIONED POSSIBILITY OF TEMPORARY MEASURES).

12. SEVERAL DELS TOOK ISSUE WITH VIEWS ADVANCED BY FRG. U.S. POINTED TO SYNDROME WHEREIN "IRRATIONAL EXPECTATIONS BECOME RATIONAL BY CONSTANT REPETITION," I.E., IF CERTAIN COUNTRIES CONTINUED TO PREACH THAT ADDITIONAL  
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STIMULUS WOULD IN ITSELF AWAKEN INFLATIONARY EXPECTATIONS, THIS PROGNOSIS COULD BE SELF-JUSTIFYING REGARDLESS OF DEGREE OF MEASURED EXCESS CAPACITY IN THE ECONOMY. U.S. NOTED THAT THESE COUNTRIES COULD AFFORD TO TAKE AN UPSIDE RISK IF OFFICIAL RHETORIC WERE TO CONCENTRATE LESS ON THE DANGER OF INFLATION. SCHULTZE, SPEAKING AS A "WARY KEYNESIAN" CITED VALUE OF TEMPORARY, REVERSIBLE MEASURES WHICH WOULD ESTABLISH THE NECESSARY CONDITIONS FOR INCREASED INVESTMENT, WHILE AWAITING IMPLEMENTATION OF PERMANENT STRUCTURAL POLICIES WHICH WOULD CONSTITUTE THE SUFFICIENT CONDITIONS. WHEREAS, FRG RELIANCE ON MEDIUM-TERM INVESTMENT PROGRAM REPRESENTED VIEW THAT NECESSARY AND SUFFICIENT CONDITIONS SHOULD BE OBTAINED SIMULTANEOUSLY. HENCE, DIFFERENCE BETWEEN U.S. AND FRG POLICY APPROACH LAY PARTLY IN DESIRED TIMING OF ESTABLISHMENT OF NECESSARY CONDITIONS SECRETARIAT NOTED THAT HIGH GERMAN IMPORT ELASTICITY IMPLIED THAT ADDITIONAL STIMULUS WOULD NOT PLACE INFLATIONARY PRESSURE ON FRG'S DOMESTIC RESOURCES.

13. JAPAN SHARED (IN LESSER ROLE) LIMELIGHT OF CRITICISM WITH FRG. JAPANESE (TANAKA) NOTED THAT FORECAST RETURN TO CURRENT ACCOUNT EQUILIBRIUM IN FY-1977 WOULD HELP PROCESS OF INTRA-OECD ADJUSTMENT. THEY STRESSED, HOWEVER, THAT GOJ FOCUS WOULD BE ON REDUCING INFLATION AND THAT ADJUSTMENT OF CURRENT ACCOUNT POSITION SHOULD BE LEFT TO MARKET FORCES. IN ADDITION, JAPANESE SAID THAT CURRENT ACCOUNT SURPLUS WAS NECESSARY IN ORDER FOR THEM TO CONTINUE CAPITAL EXPORTS TO LDC'S. TANAKA ADDED THAT STRONG COUNTRIES WERE DOING THEIR PART AND SUPPORT FRG POSITION THAT BURDEN OF INCREASING POLICY DIFFERENTIATION RESTED WITH DEFICIT COUNTRIES. SECRETARIAT (MARRIS) INSISTED THAT TENDENCY TOWARD MARKET SHARING ARRANGEMENTS AND THUS ARTIFICIAL RESTRICTIONS ON EXPORTS TOGETHER WITH \$3.5 BILLION RISE IN JAPANESE RESERVES LAST YEAR HARDLY GAVE  
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IMPRESSION THAT GOJ WAS ALLOWING MARKET FORCES ADJUST CURRENT ACCOUNT POSITION. SECRETARIAT (FAY) SUGGESTED THAT GOJ SHOULD (A) EXPAND DOMESTIC DEMAND; (B) LET YEN APPRECIATE AND (C) INCREASE ODA.

14. OF THE DEFICIT COUNTRIES, U.K. (WASS) WAS THE MOST FORCEFUL IN ARGUING THAT STRONG COUNTRIES SHOULD SHOULDER BURDEN OF GETTING THE DEGREE OF DEMAND MANAGEMENT POLICY DIFFERENTIATION NECESSARY TO ACCELERATE ADJUSTMENT PROCESS. WASS ADVANCED FOLLOWING ARGUMENTS: (A) MARKET FORCES FOR ADJUSTMENT OPERATE ASSYMETRICALLY BETWEEN DEFICIT AND SURPLUS COUNTRIES (I.E., SURPLUS COUNTRIES CAN PREVENT APPRECIATION, BUT LIMITED RESERVES CONSTRAIN DEFICIT COUNTRY INTERVENTION); (B) INSTITUTIONAL FACTORS REINFORCE MARKET ASSYMETRY (E.G., IMF IMPOSES CONDITIONS ON BORROWERS, BUT "SCARCE CURRENCY CLAUSE" HAS NEVER BEEN INVOKED); (C) COMPRESSION OF DOMESTIC DEMAND IN DEFICIT COUNTRIES HAS SOCIAL AND POLITICAL LIMITS. IT CAN ALSO BE INFLATIONARY SINCE DRIVING DOWN REAL INCOMES CAN GENERATE INFLATIONARY WAGE CLAIMS (ITALIANS SUPPORTED THIS VIEW BY NOTING THAT IN THEIR CASE, LABOR HAD BECOME A FIXED COST; THUS FALLING LEVELS OF ACTIVITY PUT STRONG UPWARD PRESSURE ON UNIT COSTS); (D) SURPLUS COUNTRIES HAD UNDERESTIMATED THEIR OWN SELF-INTEREST IN ACHIEVING FULLER CAPACITY UTILIZATION (E.G., SLOW GROWTH AND RESULTANT WEAK INVESTMENT HAS REDUCED RATE OF TECHNOLOGICAL ADVANCE IN FRG). U.K. (DOW) ADDED THAT SURPLUS

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COUNTRIES SHOULD CONSIDER DANGER OF "BACKLASH" ON THEIR EXPORTS AS DEFICIT COUNTRIES WERE FORCED DOWN ROAD OF TRADE RESTRICTIONS. IN GLOOMY INTERVENTION, HE NOTED THAT BECAUSE OF INADEQUATE POLICY STANCE OF MOST SURPLUS COUNTRIES AND EXPECTED CONTINUATION OF LARGE OECD CURRENT ACCOUNT DEFICIT OUTLINED IN REF B, SECRETARIAT SHOULD FORMULATE "PESSIMISTIC" MEDIUM-TERM SCENARIO SO THAT EPC COULD CONSIDER ITS CONSEQUENCES. IN THIS CONTEXT, U.K. NOTED THAT CURRENT ACCOUNT DEFICIT WITHIN OECD AREA WAS AS MUCH A BURDEN AS THE AREA'S COLLECTIVE DEFICIT WITH OPEC AND SUGGESTED THAT ELIMINATION OF THE FORMER WOULD RENDER LATTER SUSTAINABLE. FRG (LAHNSTEIN) SAID THAT KNOWLEDGE BY PUBLIC THAT OECD WAS CONSIDERING SUCH A "PESSIMISTIC" SCENARIO WOULD HAVE DAMAGING EFFECT ON CONFIDENCE. (EMMINGER COMMENTED THAT USE OF PROVISIONAL PROJECTIONS PREPARED BY SECRETARIAT FOR WP-3 WAS "INADMISSABLE" IN EPC POLICY DISCUSSIONS.)

15. OTHER "HARD-LINERS" AMONG THE DEFICIT COUNTRIES  
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INCLUDED NEW ZEALAND AND TURKEY. NEW ZEALAND ARGUED THAT COMMITMENTS CONCERNING DEMAND MANAGEMENT POLICY STANCE IN SURPLUS COUNTRIES SHOULD BE QUID PRO QUO FOR RENEWAL OF OECD TRADE PLEDGE. TURKS SAID THAT "RULES OF THE GAME" NOW BIASED AGAINST DEFICIT COUNTRIES AND THAT STRONG COUNTRIES SHOULD ACCEPT LIMITS ON THE ACCUMULATION OF SURPLUSES. (FRG REPLIED THAT IT WOULD BE GLAD TO BE SHOWN HOW IT COULD GET RID OF ITS CURRENT ACCOUNT SURPLUS.) IN SHARP CONTRAST, AUSTRALIA (STONE) STRESSED THAT WEAK COUNTRIES SHOULD SHOULDER MORE OF THE ADJUSTMENT BURDEN. HE ADDED THAT THE CONTINUATION OF NON-INFLATIONARYR GROWTH BASED ON PRUDENT POLICIES BY THE STRONG COUNTRIES WOULD BE BENEFICIAL TO THE WEAK COUNTRIES. STONE BUTTRESSED HIS CASE WITH SEVERAL QUOTES FROM RECENT IMF "WORLD OUTLOOK" WHICH URGED COUNTRIES TO MAINTAIN STEADY, PREDICTABLE DEMAND MANAGEMENT POLICIES AND AGREED WITH FRG VIEW THAT ADOPTION OF "FINE TUNING" APPROACH TO DEMAND MANAGEMENT HAD DESTABILIZING EFFECT ON PRIVATE SECTOR. STONE COMMENTED THAT PRESCRIPTION FOR FASTER

GROWTH IN SURPLUS COUNTRIES WOULD BE APPROPRIATE IF LACK OF EXTERNAL DEMAND WERE THE DEFICIT COUNTRIES' ONLY PROBLEM; HOWEVER, THEIR PROBLEMS BEGIN AT HOME.

16. POSITIONS OF MOST DEFICIT COUNTRIES FELL IN BETWEEN ABOVE EXTREMES. THESE COUNTRIES NOTED THE POLITICAL, SOCIAL AND ECONOMIC DANGERS THAT WOULD RESULT FROM CONTINUED RESTRAINT OF DOMESTIC DEMAND, AND SAID THAT STRONGER GROWTH IN SURPLUS COUNTRIES WOULD MAKE THEIR OWN TASK EASIER. HOWEVER, THEY DID NOT PRESS SURPLUS COUNTRIES TO REFLATE. RATHER, THEY SAID THAT WHEN RISKS BETWEEN SHORTFALL IN GROWTH AND HIGHER INFLATION IN SURPLUS COUNTRIES ARE UNCERTAIN, LATTER SHOULD LEAN TOWARD TAKING RISK ON SIDE OF EXPANSION. FRENCH (DELAROSOISE) WERE SOMEWHAT MORE DIRECT. THEY ARGUED THAT ADDITIONAL STIMULUS WOULD BE IN FRG'S OWN INTEREST AND THAT OTHER COUNTRIES SHOULD CONSIDER WITH FRG HOW CERTAIN OBSTACLES

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TO STIMULUS (I.E., LARGE BUDGET DEFICIT) COULD BE OVERCOME.

17. SWEDEN ARGUED THAT DIFFERENTIAL DEMAND MANAGEMENT POLICIES WERE NOT SUFFICIENT TO ACCELERATE ADJUSTMENT PROCESS SINCE CAUSES OF MALDISTRIBUTION OF DEFICIT WERE STRUCTURAL. ADJUSTMENT REQUIRED THAT SURPLUS COUNTRIES REDUCE THE RELATIVE SHARE OF THE INDUSTRIAL (I.E., TRADE) SECTOR AND INCREASE THAT OF SERVICE SECTOR (I.E., NON-TRADE), WHILE OPPOSITE NECESSARY IN DEFICIT COUNTRIES.

18. IN DISCUSSING ROLE OF DEMAND POLICIES IN ACCELERATING THE ADJUSTMENT PROCESS, AUSTRALIANS STRESSED THAT OECD'S MEDIUM-TERM STRATEGY SHOULD NOT BE INTERPRETED AS A STATISTICAL EXERCISE IN GROWTH TARGETRY, BUT AS A SET OF POLICY GUIDELINES WHICH INCLUDED A QUANTITATIVE ILLUSTRATION OF WHAT ADHERENCE TO THOSE GUIDELINES WOULD MEAN FOR OECD AREA GROWTH. THUS, ARGUED STONE, IT WAS INAPPROPRIATE TO USE THE STRATEGY'S GROWTH FIGURES TO EVALUATE THE ACTUAL PERFORMANCE OF A MEMBER COUNTRY. EPC (PARTICULARLY FRG AND JAPAN) CONSENSUS ENDORSED AUSTRALIAN POSITION.

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19. ROLE OF EXCHANGE RATES IN ADJUSTMENT PROCESS: THE FEW COUNTRIES WHICH ADDRESSED QUESTION OF ROLE EXCHANGE RATES COULD PLAY IN FURTHERING ADJUSTMENT PROCESS WERE SKEPTICAL AS TO CONTRIBUTION EXCHANGE RATE CHANGES COULD MAKE IN THIS RESPECT. DELAROSIERE (REPEATING WHAT HE HAD SAID AT WP3) COMMENTED THAT EXCHANGE RATE ADJUSTMENT WAS USEFUL, BUT HAD LIMITS. REDUCTION OF DOMESTIC INFLATION AND PURSUIT OF CAUTIOUS DOMESTIC DEMAND POLICY, AS WELL AS SELECTIVE MEASURES TO BRING ABOUT STRUCTURAL CHANGES, WERE ESSENTIAL TO ACHIEVE ADJUSTMENT. DEPRECIATION OF FRANC HAD ADDED \$2 BILLION TO FRENCH IMPORT BILL IN 1976, WHILE EXPORTS HAD NOT GROWN AS RAPIDLY AS EXPECTED BECAUSE FRENCH FIRMS HAD IMPROVED PROFIT MARGINS, RATHER THAN LOWERING FOREIGN CURRENCY PRICES. CANADA (HOOD) STATED THAT BENEFITS OF DEPRECIATION WOULD BE SHORT-LIVED IF INFLATION INDUCED BY DEPRECIATION WERE ALLOWED TO WIPE OUT COMPETITIVE ADVANTAGE THUS GAINED. HE ADDED THAT "RIGHT" TO DEVALUE OR DEPRECIATE MUST BE EARNED BY MASTERING DOMESTIC INFLATION. (HE DID NOT  
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EXPLORE THE "CATCH 22" NATURE OF THIS SUGGESTION.)

20. CANADA QUESTIONED CONCENTRATION ON CURRENT ACCOUNT SURPLUS AS MEASURE OF IMBALANCE WITHIN OECD AREA OR BETWEEN OECD AND OPEC. HOOD ADVOCATED BROADER VIEW WHICH WOULD FOCUS ON DYNAMIC TRADE AND FINANCIAL RELA-

TIONSHIP AMONG COUNTRIES, BALANCING THE INTERESTS OF THE VARIOUS COUNTRY PARTICIPANTS IN THE ADJUSTMENT PROCESS. SEVERAL COMBINATIONS OF CURRENT AND CAPITAL ACCOUNT BALANCES COULD BE SUSTAINABLE. NETHERLANDS AGREED THAT LARGER PERSPECTIVE WAS APPROPRIATE AND SUGGESTED THAT BASIC BALANCE REPLACE CURRENT ACCOUNT AS MEASURE OF RELATIVE EXTERNAL PERFORMANCE. IN STATING THAT TRAGEDY OF OIL PRICE INCREASE WAS THAT RESULTING FORCED SAVINGS HAD NOT BEEN TRANSFORMED INTO PRODUCTIVE INVESTMENT, U.S. ALSO LEANED TOWARD SOMEWHAT BROADER APPROACH TO ADJUSTMENT PROCESS.

21. SECRETARIAT (MARRIS), RELATIVELY RESTRAINED FOR MOST PART, COMMENTED EXTENSIVELY NEAR CLOSE OF MEETING ON VIEWS PUT FORWARD BY COUNTRY DELS. HIS MAIN POINTS INCLUDED: (A) CURRENT ACCOUNT BALANCE IS VALID INDICATOR OF MAGNITUDE OF ADJUSTMENT PROBLEM BECAUSE IT MEASURES ACCUMULATION OF DEBT AND IS SUSTAINABLE ONLY IF DEFICIT COUNTRIES GENERATE PRODUCTIVE CAPACITY TO SERVICE CLAIMS ON THEIR RESOURCES AND THUS MAINTAIN COMPETITIVENESS; (B) POLITICAL AND TECHNICAL IMPEDIMENTS TO SHORT-RUN ADJUSTMENT CALLED FOR ACTION TO ESTABLISH OECD FINANCIAL SUPPORT FUND; (C) BECAUSE OF STIMULUS IN U.S. AND STABILIZATION MEASURES IN UK AND FRANCE, CONFIDENCE HAS IMPROVED; NEVERTHELESS, TWO YEARS INTO RECOVERY FROM RECESSION, OECD GROWTH PERFORMANCE LIES BELOW LEVELS IMPLIED BY MEDIUM-TERM STRATEGY; (D) WHILE THIS STRATEGY SHOULD NOT BE INTERPRETED AS GROWTH TARGET, A CONDITION FOR SUCCESS OF THE STRATEGY WAS GROWTH AT RATE ABOVE INCREASE OF POTENTIAL GROWTH, THUS ENABLING UNEMPLOYMENT

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TO BE REDUCED, RATHER THAN TO ERADICATE INFLATION AND HOPE FOR FALL IN UNEMPLOYMENT (I.E., MARRIS' INTERPRETATION OF AUSTRALIAN VIEW); (E) ADJUSTMENT PROCEEDING TOO SLOWLY. FRG HAS ABNORMAL EXCESS OF PRIVATE SAVINGS OVER PRIVATE INVESTMENT AND SHOULD ADOPT TEMPORARY STIMULATORY FISCAL MEASURES (A LA U.S.) TO MAINTAIN EXPANSION OF WORLD TRADE; DEFICIT COUNTRIES ARE BEING ASKED TO TAKE STRONGER MEDICINE THAN ARE SURPLUS COUNTRIES; (F) ARGUMENTS AGAINST "FINE TUNING" ARE IRRELEVANT WHEN PRIME SOURCE OF INSTABILITY LIES IN PRIVATE RATHER THAN IN PUBLIC SECTOR. FRG (LAHNSTEIN) RESPONDED TO MARRIS BY NOTING THAT TERMS SUCH AS "FINE TUNING," "SOFT LANDINGS" AND "ADAGIO SOSTENUTO DID NOT EVOKE REACTION FROM GERMAN PUBLIC WHEREAS UNEMPLOYMENT RATE WAS CENTER OF POLITICAL FOCUS. THUS EPC COULD BE CONFIDENT THAT FRG GOAL WAS MAXIMUM RATE OF GROWTH AND LOWEST RATE OF UNEMPLOYMENT WHICH WAS CONSISTENT WITH ACCEPTABLE RATE OF INFLATION.

22. EPC BUREAU MEETING AND DINNER: AT MARCH 1 BUREAU MEETING AND DINNER, MEMBERS AGREED THAT: (A) SECRETARIAT WOULD PREPARE UPDATED ASSESSMENT OF ECONOMIC OUTLOOK WHICH WOULD BE DISCUSSED AT INFORMAL BUREAU LUNCH HOSTED BY CHAIRMAN SCHULTZE DURING IMF INTERIM COMMITTEE MEETING

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IN WASHINGTON (APRIL 27-28). NEITHER ASSESSMENT NOR BUREAU MEETING WOULD BE FORMALLY TIED TO SUMMIT; (B) EPC CHAIRMAN ALLEN WOULD TAKE GENERAL LINE AT MARCH 2 PRESS CONFERENCE THAT IF BOTH SURPLUS AND DEFICIT COUNTRIES SUCCEED IN THEIR RESPECTIVE OBJECTIVES, THERE IS CAUSE FOR OPTIMISM CONCERNING BOTH MACRO-ECONOMIC OUTLOOK AND PAYMENTS ADJUSTMENT. HOWEVER, THESE NATIONAL GOALS WILL BE HARD TO ACHIEVE. (NOTE: AT ACTUAL PRESS CONFERENCE FOCUS OF QUESTIONING WAS ON DEGREE TO WHICH OTHER COUNTRIES, PARTICULARLY U.S., PUSHED FRG TO REFLATE. ALLEN RESPONDED THAT NO MAJOR COUNTRY URGED GERMANY TO TAKE SUCH ACTION, ALTHOUGH A NUMBER OF EPC MEMBERS EXPRESSED THE NEED FOR ACTION BY SURPLUS COUNTRIES.)

23. BUREAU ALSO HAD LOOSE, INCONCLUSIVE DISCUSSION OF MEDIUM-TERM STRATEGY APPROACH TO ECONOMIC POLICY COOPERATION AND GENERAL EXCHANGE ON U.S. ENERGY POLICY.

24. ABOVE REPORTS ON BRIEF TALK WITH JOURNALIST (PARA-  
GRAPH 3) AND ON BUREAU MEETING AND DINNER (PARAGRAPHS  
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22-23) BASED ON BRIEFING BY CHAIRMAN SCHULTZE, BUT HAVE  
NOT BEEN CLEARED BY HIM.  
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